[redacted]

[redacted]

Petitioner,

[redacted]

Respondent.

[redacted]

[redacted]

[redacted]

FRANK J. KELLEY
Attorney General

[redacted]
Solicitor General

THOMAS L. CASEY
Assistant Solicitor General
Counsel of Record
P.O. Box 30212
Lansing, Michigan 48909
(517) 373-1124

RICHARD R. ROESCH
Assistant Attorney General
Attorneys for Respondent

BEST AVAILABLE COPY

QUESTIONS PRESENTED

1. Does Michigan's Single Business Tax Act impose an extraterritorial tax upon Trinova Corporation's activities in violation of the Due Process Clause by employing the evenly weighted three-factor apportionment formula of tangible property, payroll and sales to attribute value added by a unitary multistate business?

2. Does such formulary apportionment of value added constitute economic protectionism designed to benefit instate economic interests by burdening out-of-state competitors in violation of the Commerce Clause?

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CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

In addition to the provisions listed in Pet App 59a, 62a, the Single Business Tax provided in 1980 in pertinent part:

MICH. COMP. LAWS § 208.3(2):

> "'Business activity' means a transfer of legal or equitable title to or rental of property, whether real, personal, or mixed, tangible or intangible, or the performance of services, or a combination thereof, made or engaged in, or caused to be made or engaged in, within this state, whether in intrastate, interstate, or foreign commerce, with the object of gain, benefit, or advantage, whether direct or indirect, to the taxpayer or to others, but shall not include the services rendered by an employee to his employer, services as a director of a corporation, or a casual transaction. Although an activity of a taxpayer may be incidental to another or other of his business activities, each activity shall be considered to be business engaged in within the meaning of this act."

MICH. COMP. LAWS § 208.9

> "(1)'Tax base' means business income, before apportionment, or allocation as provided in chapter 3, even if zero or negative, subject to the adjustments in subsections (2) to (9).

(2) Add gross interest income and dividends derived from obligations or securities of states other than Michigan, in the same amount that was excluded from federal taxable income, less related expenses not deducted in computing federal taxable income because of section 265 of the internal revenue code.

(3) Add all taxes on or measured by net income and the tax imposed by this act to the extent the taxes were deducted in arriving at federal taxable income.

(4) Add, to the extent deducted in arriving at federal taxable income:

(a) Any carryback or carryforward of a net operating loss.

(b) Any carryback or carryforward of a capital loss.

(c) Any deduction for depreciation, amortization, or immediate or accelerated writeoff related to the cost of tangible assets for which a capital acquisition deduction was claimed in any tax year pursuant to section 23, and for the 1976 tax year, 72%, and for the 1977 tax year and subsequent tax years 100% of any deduction for other depreciation, amortization, or immediate or accelerated writeoff related to the cost of tangible assets.

(d) Any dividends paid or accrued except dividends that represent reduction of premiums to policyholders of insurance companies.

(e) Any deduction or exclusion by a taxpayer due to a classification as a domestic international sales corporation, western hemisphere trade corporation, China trade act corporation or any like special classification the purpose of which is to reduce or postpone the federal income tax liability. This subsection shall not apply to the special provisions of sections 805, 815(c)(2)(A), 809, 823(c), and 824(A) of the internal revenue code.

(f) All interest except amounts paid, credited, or reserved by insurance companies as amounts necessary to fulfill the policy and other contract liability requirements of sections 805 and 809 of the internal revenue code.

(g) All royalties.

(5) Add compensation as defined in section 4(3).

(6) Add any capital gains related to business activity of individuals to the extent excluded in arriving at federal taxable income.

(7) Deduct, to the extent included in arriving at federal taxable income:

(a) Dividends received or deemed received, including the foreign dividend gross-up provided for in the internal revenue code.

(b) All interest.

(c) All royalties.

(8) Deduct any capital loss not deducted in arriving at federal taxable income in the year the loss occurred.

(9) To the extent included in federal taxable income, add the loss or subtract the gain from the tax base that is attributable to another entity whose business activities were in this state."

MICH. COMP. LAWS §§ 208.31(2), (4), (5):

"(2) As used in this section 'adjusted tax base' means the tax base allocated or apportioned to this state pursuant to chapter 3 and the adjustments permitted by section 23 and the exemptions permitted by sections 35 and 37. If the adjusted tax base exceeds 50% of the sum of gross receipts plus the adjustments provided in section 23(b) and (d), apportioned or allocated to Michigan with the apportionment fraction calculated pursuant to chapter 3, the adjusted tax base may, at the option of the taxpayer, be reduced by such excess. The taxpayer shall not be entitled to the adjustment provided in section 31(5), (6), or (7) for the same taxable year.

***

(4) The tax so levied and imposed is upon the privilege of doing business and not upon income.

(5) In lieu of the adjustment provided in subsection (2) or (3) a person may elect to reduce the adjusted tax base by the percentage that the compensation divided by the total tax base exceeds 63%. The deduction shall not exceed 37% of the adjusted tax base."

STATEMENT OF THE CASE

THE NATURE OF A VALUE ADDED TAX

A document entitled "Analysis of the Michigan Single Business Tax" prepared by the Taxation and Economic Policy Office of the Michigan Department of Treasury in January, 1985, pages 20-21[1] explains the theory underlying a value added tax:

> "Under the value-added tax concept, the tax base is the difference between the value of the product at sale and the cost of goods purchased from other businesses that went into the product. That difference is the 'value added' to those materials by the production process. A simple example, outlined below, illustrates the value added concept.

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[1]A copy of the entire document has been lodged with the Clerk of the Court, see Petitioner's brief, p 9, n 6.

VALUE ADDED TAX EXAMPLE

Business: Bakery

Costs:
- Labor - Baker, Sales Clerk
- Materials - Flour, Sugar, Spices, Utilities
- Capital - Building, Mixer, Utensils, Oven
- Credit - Interest Paid on Loans

Revenue = Cost Labor + Cost Materials
+ Depreciation + Interest
+ Profit

Value Added = Revenue - Cost Materials
= Cost Labor + Interest + Profits + Depreciation

"In this example, a bakery's costs are for labor, materials, capital goods and credit. The sum of these costs plus the firm's profit equals, by definition, the total revenue or sales of the business. Value-added may be defined as revenue minus materials costs, that is the difference between the sales value of the final product and the value of the goods used in producing the product.

"The next issue for a value-added tax is determining how to calculate the tax base or value added. What the example makes clear is that there are two alternative, but equivalent ways of calculating value added. One alternative is to simply start with sales and subtract material costs. Another way is to add up profits plus labor costs plus interest paid plus depreciation. The important point is that, conceptually, these two calculations are equal. That is,

SALES - MATERIALS = PROFITS + LABOR + INTEREST PAID + DEPRECIATION

"This must be true because it simply is a reorganization of the statement that sales less costs equals profits. Both sides of this equation equal value-added and could be used to calculate the tax base."

The member nations of the European Economic Community employ yet a third method of tax base determination, the invoice-credit method. They administer their VAT[2] as if it were a multi-stage sales tax. The supplier

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[2]VAT will be hereinafter used to refer to the term value-added tax.

of raw material levies the VAT rate on the sales price and bills it to the manufacturer. The manufacturer collects from the wholesaler a VAT on the price of the manufactured product. He reports to the taxing authority the VAT collected and takes a credit for VAT paid to his supplier. In the case of tax audit the supplier's invoice is used to justify the credit. The wholesaler and retailer follow the same course. They collect the VAT on the selling price and remit as tax the difference between the VAT collected from customers and VAT paid to their suppliers.

The computational mechanics of the above methods do not purport to determine the situs and jurisdiction where the value is added. The addition or subtraction method is designed to determine only the incremental value or cost added to a product or service

by business activities. The invoice method used by the European Economic Community directly determines the tax on such value or cost at the point of each sale in the production chain. In each method the geographic location of the components is not a consideration.

All business enterprises combine labor, capital, and managerial skills hoping to produce business income. To turn this hope into reality the goods and services of the enterprise must be marketed. The market, reflecting the preference of consumers, determines the gross income the goods and services command. The gross income realized by the enterprise may be greater than, equal to, or less than its production costs. This is a consequence of a free market system; businesses may temporarily or permanently

fail to generate sales sufficient for those who have contributed labor, capital, or entrepreneurial skills to recover their contribution.

Market prices are indivisible and incapable of reflecting the portion of the price attributable to factors that went into the production of the good or service. Because there is no consistent correlation between the production costs of an enterprise and either its gross income or the payments made to other enterprises, production costs such as compensation and depreciation cannot be used as direct measures of value added.

Since value added is the difference between the gross receipts from the sale of goods and services and the amounts paid to others for goods and services which were incorporated therein, certain attributes of

value added are obvious. First, value added is dependent upon a market. Second, its magnitude is correlated with the gross income which products and services command in the market. Third, goods or services do not contribute to value added until they are sold. Finally, value added is created by two elementary factors: business gross receipts from sale of finished products and material payments to other businesses which supplied the raw material.

THE NATURE OF MICHIGAN'S SINGLE BUSINESS TAX

> "The single business tax is a form of value added tax, although it is not a pure value added tax." Trinova Corp v Treasury Department, 433 Mich 141, 149 (1989) (Pet App 10a)

It is considered not to be a pure value added tax

> " ... because of various exclusions, exemptions, and industry-specific adjustments that were adopted by the

Legislature when the tax was enacted." 433 Mich at 149, fn 6.

Michigan's Single Business Tax, Act 228 of the Michigan Public Acts of 1975; MCL 208.1 et seq, effective January 1, 1976, replaced seven taxes upon business[3]. It also exempted persons subject to the single business tax from the specific tax imposed on intangible personal property by 1939 PA 301; MCL 205.131 et seq; MSA 7.556(1) et seq, and concurrently the ad valorem property tax on inventories was repealed by 1975 PA 234; MCL 211.9c; MSA 7.9(3). Corporations engaged in manufacture and sale of products became sub-

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[3]The domestic building and loan and savings and loan privilege tax; the foreign building and loan and savings and loan privilege tax; the federal savings and loan privilege tax; the domestic insurance company privilege tax; the financial institution income tax; the corporate income tax and the annual corporation privilege (franchise) tax.

ject to a single tax for the privilege of doing business. Prior to 1976 they had been subjected to an annual franchise tax measured by their capital and surplus, i.e., their net worth; an income tax measured by federal taxable income with some modifications; a specific property tax upon their intangibles, mainly stock portfolios and accounts receivable; and an ad valorem property tax upon their inventories.

The net worth franchise tax, the income tax and the intangible property tax each contained a three-factor apportionment formula of property, payroll and destination sales. Michigan's portion of a multistate corporation's net worth, income or intangible property was apportioned by a factor which resulted from addition of the Michigan percentages of a taxpayer's property, payroll

and sales and dividing the aggregate by 3, the number of factors.

The Single Business Tax which was substituted for these separate taxes, retains the identical apportionment formula. It is "a tax upon business activity" and "its intended effect is to impose a tax upon the privilege of conducting business activity within Michigan", (Opinion of Michigan Supreme Court, Pet App 10a). It is measured by modified, apportioned value added which is the difference between the gross receipts from the sale of products and services and the costs of materials purchased from others that were incorporated in the sold products and services.

The SBT employs the addition method of calculating value added which is stated by the equation:

value added = labor costs + interest + profits + depreciation.

As explained by the Michigan Supreme Court (Pet App 11a), the tax base of value added is computed by adding to business income which "is essentially federal taxable income" (the profit element in the equation) a taxpayer's compensation (labor costs), depreciation expense, and the interest, dividends and royalties paid.

The alternative method of value added computation, the subtraction method, representing the equation:

value added = revenue (gross receipts) - material costs

was formerly used by the Michigan Business

Activities Tax,[4] a modified value-added tax which had been in effect from 1953 to 1967. The BAT and the SBT resemble each other in all essential details, are imposed on the identical subject, apportioned by identical 3-factor formula, and even contain similar relief provisions for labor-intensive businesses (the excess compensation reduction). These facial similarities clearly reveal the SBT as a descendant of the BAT.

In "Developments in the Law: Federal Limitations On State Taxation of Interstate

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[4]Robert J. Kleine, The Michigan Single Business Tax: A Different Approach to State Business Taxation, Advisory Commission on Intergovernmental Relations (Washington, D.C. March 1978) where the author states at page 17: "The Michigan Single Business Tax represents a return to the philosophy of business taxation which was in effect in Michigan from 1953 to 1967. In these years, Michigan imposed the business activities tax [BAT] also a form of value-added tax."

Business" 75 Harvard Law Review, 953, 1020 (1960-61), the observation is made that the Michigan Business Activities Tax "seems to fall halfway between the net income and the gross receipts taxes." The article discusses this Michigan tax under the heading of "Value-Added Taxes" at 75 Harvard Law Review 1026, 1027 (footnotes omitted):

> "The Michigan business activities tax is grounded on the assumption that the value which an enterprise adds to the goods and services it sells is the difference between the value of its output, measured by its gross receipts, and the value of the goods it purchases in order to obtain this output.
>
> " ...
>
> "The base of the Michigan tax is derived by deducting from gross receipts all purchases of noncapital assets from other firms, depreciation of real property, interest and rent, and taxes other than income taxes. Unlike a pure value-added tax, depreciation expense of personalty is not deductible, seemingly in order to avoid putting labor at a competitive disadvantage with machinery. A further departure from theory allows a reduction in the tax when net income is low compared to adjusted receipts.

" ...

" ... the Michigan statute employs a three-factor 'Massachusetts-type' apportionment formula. The Michigan Supreme Court, in Armco Steel Corp. v. Department of Revenue, held the tax and its apportionment formula constitutional whether the tax was construed as a net income or a gross receipts tax. The Supreme Court dismissed the appeal."

Armco Steel Corp v Department of Revenue, 359 Mich 430, app dismissed, 364 US 337 (1960), rejects the contention that the relative diminutiveness of the payroll and property fractions when compared to the sales fraction indicates a distortion of the attribution method.[5] The statutory 3-factor for-

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[5]The Michigan Supreme Court noted, 359 Mich at 436, that the taxpayer's Michigan payroll factor was less than 1/10 of 1%, its property factor less than 1/400 of 1% and that Michigan destination sales approximated 8.78% of its total receipts. Trinova's activities in Michigan were somewhat more extensive than those of Armco. Trinova's Michigan payroll factor was less than 1/4 of 1% (.2328%), its property factor less than 1/10 of 1% (.0930%) and its sales factor 26.5892% [Pet brief p 15].

mula attributed to Michigan less than 3% of Armco's "adjusted receipts" (the measure of the tax) for "the privileges, opportunities and protection Plaintiff enjoys in conducting its interstate business in the state" (the subject of the tax) 359 Mich 452. The Court observed that:

" ... this tax on Michigan business activities is arrived at by imposing a rate and applying an apportionment formula to 'adjusted receipts' or 'income' derived from or attributable to Michigan sources. We have previously considered the applicability of the income tax case decisions, on the ground that the extent, character, and details of exemptions and deductions from gross proceeds are not decisive of the question of the nature of the tax. So considered, the case of Northwestern States Portland Cement Co. v. Minnesota, 358 US 450 (79 S Ct 357, 3 L Ed 2d 421), is definitely controlling. ..." (359 Mich 452, 453).

Like the BAT, the SBT cannot be construed as a net income tax or a pure gross receipts tax and should be regarded like the BAT (75

Harvard Law Review, 1020) as conceptually "falling halfway between" such levies.

The business community works with an income continuum that starts with gross income and terminates with net income. The SBT base of (modified) value added lies at the mid-point of this continuum which provides two ways of arriving at value added. One can start at the beginning of the continuum, gross income, and subtract only payments for materials to other businesses which is the subtraction method of value added computation. Alternatively, one can start at the end of the continuum, net income, and add back any deductions made in arriving at net income that are not deductible from gross income when computing value added because they are not payments made for raw materials. This is the addition method of calculation.

It should logically follow that, if apportioned net income or apportioned gross receipts are proper measures for a tax on in-state aspects of a multi-state enterprise, Western Live Stock v Bureau of Revenue, 303 US 250, 255, 256 (1938), then ipso facto such in-state aspects, activities and privileges are also measurable by apportioned value-added.

The similarity between the SBT and a gross receipts tax is illustrated by the optional method of tax computation which is commonly called the "gross receipts method". The SBT provides that "at the option of the taxpayer" the adjusted tax base (against which the 2.35% rate is levied) shall be 50% of apportioned gross receipts. SBTA §31(2) MCL 208.31(2); MSA 7.558(31)(2). As a result, no firm's SBT should ever exceed

1.175% of apportioned gross receipts. Statistics of the Michigan Department of Treasury indicate that more than 12,000 (12%) of approximately 96,000 taxpayers (accounting for about 6% of total SBT revenue) claim the 50% gross receipts reduction.

The data set forth at pages 14-15 of Petitioner's brief and in stipulated facts (Pet App 56a) will serve to illustrate the computational mechanics of the SBT. It brings into focus the addition method of tax-base determination used by the majority (nearly 88%) of taxpayers and the optional method which consists of a 50% reduction of apportioned gross receipts.

Gross Receipts (Total Sales)		$391,065,866
Business Income (U.S. taxable income)	(42,466,114)	
Compensation	226,356,271	
Depreciation	23,262,909	
Interest, Dividends, Royalties Paid	22,908,950	
Other Additions	549,526	
Less Interest, Dividends, Royalties Received	(9,486,223)	
Tax base	$221,125,319	
Apportionment		
Property factor	.0930%	
Payroll factor	.2328%	
Sales factor	26.5892%	
Average factor	8.9717%	x 8.9717%
Apportioned tax base	$ 19,838,700	$ 35,085,256
Less Net Capital Acquisition Deduction	9,064	
Adjusted tax base	19,829,636	
Less 50% of gross receipts		17,542,628
Optional tax base		17,542,628

The foregoing illustration indicates that Trinova could have chosen to apply the tax rate of 2.35% to its optional tax base consisting of 50% of apportioned gross receipts. However, such election would have disqualified it from claiming the "excess compensation reduction" granted by SBTA §31(5), MCL 208.31(5); MSA 7.558(31)(5). Trinova's tax base for 1980 was $221,125,319. Since its compensation ($226,356,271) exceeded the tax base, it was entitled to the maximum reduction of 37% from its apportioned tax base. Such reduction finalized its tax base at $12,492,671 (Petitioner's brief p 15), i.e., at 63% of its apportioned value-added of $19,829,636.[6]

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[6]It is entirely accurate to state that the SBT is imposed on modified apportioned value added which in Trinova's case is 63% of apportioned value added.

THE GENESIS OF THIS CASE

Trinova filed its 1980 SBT return electing the addition method of computing tax liability. The return showed: (i) business income (loss) of $(42,466,114)[7]; (ii) additions to business income of $273,077,656; (iii) deductions from business income of $9,486,223; (iv) a pre-apportionment tax base of $221,125,319; (v) a Michigan apportionment factor of 8.9717%; (vi) a Michigan apportioned tax base of $19,838,700; (vii) deductions for high labor costs and capital acquisitions totaling $7,346,029; (viii) a Michigan adjusted tax base after special deductions of $12,492,671; and (ix) a tax liability of $293,578. (Petitioner's brief pp 14-15).

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[7]Statutory (business income) = federal taxable income.

In 1985 Trinova filed an amended 1980 return and asked for permission to use an alternate method of tax computation consistent with the decision of the Michigan Court of Appeals in Jones & Laughlin Steel Corp v Department of Treasury, 145 Mich App 405 (1985), which cast doubt upon the manner in which the SBT apportionment formula was being applied to out-of-state businesses.

In its amended 1980 return Trinova did not add back any compensation or depreciation to net business income and thereby arrived at a negative amount, $(28,493,861),[8] which it treated as subject to apportionment. It next applied the statutory three factor apportion-

[8]Exclusion of compensation and depreciation ($226,356,271 + $23,262,909 = $249,619,180) converted the positive pre-apportioned tax base of $221,125,319 to a negative pre-apportioned loss of $28,493,861.

ment fraction developed in its original 1980 return, 8.9717%, to this total negative amount to arrive at the Michigan portion thereof, $(2,556,384). To this negative Michigan amount it added: (i) compensation paid in 1980 to its employees for services physically performed in Michigan, $511,774; and (ii) depreciation and amortization incurred in 1980 on its tangible property having a situs in Michigan in the amount of $2,152. These two adjustments brought the total amount Trinova assigned to Michigan, as its apportioned tax base, to a negative, $(2,042,458).

The Commissioner rejected Trinova's request for permission to file on this basis and its claim for refund. Trinova filed an action in the Michigan Court of Claims challenging the determinations of the

Commissioner and the Court of Claims ruled for Trinova (Pet App 42a-51a). The decision was appealed to the Michigan Court of Appeals which reversed the Court of Claims (Pet App 30a-41a) declining to follow the ruling in Jones & Laughlin Steel Corp v Department of Treasury, supra. The case was appealed to the Michigan Supreme Court which sustained the Court of Appeals (Pet App 1a-28a).

SUMMARY OF ARGUMENT

Trinova erroneously contends that the Michigan Single Business Tax violates the Due Process and Commerce Clauses because (i) the principal components of the tax base (compensation and depreciation) can be separately allocated and therefore should not be the subject of apportionment, and (ii) the apportionment formula distorts the amount of

petitioner's tax base attributed to Michigan because of the inclusion of a sales factor in the formula. They further erroneously contend that the SBT violates the Commerce Clause because it discriminates in favor of instate businesses selling their goods out-of-state, as contrasted with out-of-state businesses selling their goods instate.

Trinova's erroneous contentions are based in large part on its misunderstanding of the nature of the SBT and the composition of its tax base. The subject of the SBT justifying its imposition is business activity performed in Michigan or the privilege of doing business. This tax on activities is measured by modified value added. Value added is the difference between the gross receipts from the sale of finished goods and services and the amount paid for raw materials. Mobil Oil

Corp v Department of Treasury, 422 Mich 473 (1985); Trinova Corp v Michigan Department of Treasury, 433 Mich 141 (1989) (Pet App 1a-28a).

The measure of the SBT is computed by adding to federal taxable income (statutorily denominated "business income") the costs incurred in the production of goods and services (compensation, depreciation, interest and royalties paid) and deducting interest, royalties and dividends received. This addition method of value added determination does not convert the SBT from a single tax levied upon value added to a series of distinct taxes upon elements of cost which are fused therein. Trinova is simply wrong in its contention that the SBT tax base consists of specifically identifiable cost items that should be taxed on a separate geographical accounting basis.

Trinova completely overlooks this Court's prior pronouncements that in the case of a unitary business such as Trinova's separate geographic accounting is not constitutionally required because the contribution to value made by such factors as functional integration, centralized management and economies of scale cannot properly be reflected in a separate geographic accounting regime. In other words, the rule set forth by this Court in Container Corp of America v Franchise Tax Board, 463 US 159, reh den 464 US 909 (1983), and Mobil Oil Corp v Commissioner of Taxes, 445 US 425 (1980), is directly relevant and controlling here -- separate geographic accounting is not constitutionally required for state taxation of a unitary business.

The SBT was levied on less than 34% of the value added contained in the products

sold in Michigan by Trinova in the year 1980. This fact negates Trinova's charge that Michigan exerted its taxing jurisdiction over extraterritorial values in violation of the Due Process Clause.

The inclusion of sales in the 3-factor apportionment formula clearly satisfies the tests of internal and external consistency and reflects the importance of market demand to the production of value added. Gross receipts and its derivatives, value added or net income, are not realized until products or services are sold. These measures of business activity are generated by a series of transactions spanning the unitary enterprise of manufacture, distribution and sale. Bass, Ratcliff & Gretton v State Tax Commission, 266 US 271 (1924). The 3-factor UDITPA formula is a "benchmark" for appor-

tionment of value added as well as income. Container Corp; Amerada Hess Corp v New Jersey Department of the Treasury, 490 US __, 104 L Ed 2d 58 (1989).

Whether computed by the addition or subtraction method, value added cannot be split into components or elements of cost and profit. These cost elements, i.e., compensation, depreciation, interest paid, etc., are interdependent, must operate in conjunction and their product must be sold in order to create value added. Separate geographic accounting of these costs which are fused into value added misconstrues the SBT and is not constitutionally required. Mobil Oil Corp v Department of Treasury, supra, 422 Mich 473; Exxon Corp v Wisconsin Dept of Revenue, 447 US 207 (1980); Shell Oil Co v Iowa Department of Revenue, 488 US ___, 102 L Ed 2d 186 (1988); Amerada Hess, supra.

The inability to trace value added to production factors precludes the use of separate accounting to assign amounts of value added to each of the states in which a multistate unitary enterprise operates and warrants resort to formulary apportionment.

The SBT apportionment formula reflects the property, payroll and sales which make possible the addition of value to products. This formula is externally consistent, Container Corp, supra, because it apportions to Michigan an amount that fairly reflects the instate component of the value added by Trinova.

The Commerce Clause does not require the use of any particular formula to apportion value added or income used as a measure of activities attributable to a state. Moorman Manufacturing Co v Bair, 437 US 267 (1978).

Neither does it require fragmenting of value added and separate taxation of its fragments.

Westinghouse Electric Corp v Tully, 466 US 388 (1984); Tyler Pipe Industries, Inc v Washington State Department of Revenue, 483 US 232 (1987); Boston Stock Exchange v State Tax Commission, 429 US 318 (1977); Maryland v Louisiana, 451 US 725 (1981); American Trucking Associations, Inc v Scheiner, 483 US 266 (1987); New Energy Co v Limbach, 486 US ___, 100 L Ed 2d 302 (1988), do NOT deal with the apportionment of multistate values and are not in point. These cases apply the negative aspect of the Commerce Clause which prohibits favoritism of in-state economic interests at the expense of out-of-state competitors and geographic bias of tax exemptions and credits. Trinova's apportionment complaint which itself is premised upon

separate geographic accounting, fails to implicate this aspect of the Commerce Clause.

ARGUMENT

The essence of Trinova's argument is that Michigan's Single Business Tax violates the Due Process and Commerce Clauses because (i) the principal components of the tax base (compensation and depreciation) are capable of being allocated on a separate geographical basis and thus should not be the subject of apportionment, and (ii) Michigan's apportionment formula, because it includes a sales factor, does not reasonably reflect the value added by Trinova in Michigan and therefore produces a "grossly distorted result."

Trinova would have this Court believe that due to the nature of Michigan's Single Business Tax, the issues presented in the

instant case are somehow unique. However, once the labels are stripped away and the nature of the tax is fully understood, it is clear that well established precedents of this Court unequivocally confirm the constitutional integrity of the Michigan tax.

The Constitution imposes "extremely limited restrictions" on a State's power of taxation. Wisconsin v J C Penney Co, 311 US 435, 445 (1940); Northwestern States Portland Cement Co v Minnesota, 358 US 415, 457 (1959). Those restrictions cluster around two related principles: (1) the States are forbidden to impose extraterritorial taxes and (2) they may not impose taxes that discriminate against interstate commerce. Application of these principles requires examination of the "the unique characteristics of the statute at issue and the

particular circumstances in each case." Boston Stock Exchange v State Tax Commission, 429 US 318, 329 (1977).

This Court has evolved two distinct, although somewhat overlapping, tests to evaluate the constitutionality of state taxation of interstate commerce. As a general matter, both the Due Process Clause of the Fourteenth Amendment and the Commerce Clause of Article I, Section 8, preclude the state from taxing "value earned outside its borders." Asarco, Inc v Idaho State Tax Commission, 458 US 307, 315 (1982). This principle requires "a minimal connection" or "nexus" between the interstate activities and the taxing state. Exxon Corp, supra, 447 US at 219; Mobil Oil Corp, supra, 445 US at 436-437.

Additionally, there must exist "a rational relationship" between the measure of

a State's tax "and the intrastate values of the enterprise." Mobil Oil Corp, supra, 445 US at 437; Moorman Manufacturing Co, supra, 437 US at 272-273; Norfolk & Western Railway Co v State Tax Commission, 390 US 317, 325 (1968). The measure of a State's tax should be rationally related to a taxpayer's in-state activities and hence to the protections and benefits afforded by the State. Commonwealth Edison Co v Montana, 453 US 609, 622 (1981); Complete Auto Transit, Inc v Brady, 430 US 274, 279, reh den 430 US 976 (1977).

A tax imposed on a multistate business must consequently be limited to reach only business which is fairly attributable to the State, i.e., the tax must be fairly apportioned. Container Corp, supra, 463 US at 171; Exxon Corp, supra, 447 US at 220;

Complete Auto Transit, supra, 430 US at 279. The Constitution does not require any particular type of formulary apportionment, Moorman Manufacturing Co, supra.

In Container Corp, supra, this Court analyzed the fairness of an apportionment formula in terms of its internal and external consistency, 463 US at 169:

> "The first, and again obvious component of fairness in an apportionment formula is what might be called internal consistency--that is, the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business' income being taxed. The second and more difficult requirement is what might be called external consistency--the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated."

The internal consistency of the SBT apportionment formula is conceded. Trinova disputes its external consistency.

I.

THE THREE-FACTOR APPORTIONMENT FORMULA DOES NOT PROJECT THE STATE'S TAXING AUTHORITY BEYOND ITS BORDERS IN VIOLATION OF THE DUE PROCESS CLAUSE.

A. TRINOVA REALIZED VALUE ADDED OF MORE THAN $58,000,000 IN MICHIGAN, MICHIGAN ASSERTED TAXING JURISDICTION OVER LESS THAN $20,000,000 OF SUCH VALUE ADDED AND IT SUBJECTED TO TAX LESS THAN $12,500,000 OF APPORTIONED MODIFIED VALUE ADDED.

The facts in the case at bar establish that in 1980 Trinova had total gross receipts from sale of its products of $391,065,866 (Pet App 56a). Trinova reported $221,125,319 (Petitioner's Brief p 15) or 56.6% of that amount as total or preapportioned tax base. This represents the value added by Trinova's unitary business activities nationwide. Stated another way, on the average, e n dollar of Trinova's gross receipts consisted of 56.6 cents of value added.

In Michigan, Trinova realized gross receipts of $103,981,354 (Pet App 56a) in the year 1980. These gross receipts thus reflect value added of $58,853,446 (56.6%).[9] No constitutionally valid objection could be made if Michigan were to impose a tax upon either such gross receipts or the value added contained therein. General Motors Corp v Washington, 377 US 436 (1964); Standard Pressed Steel Co v Washington Revenue Department, 419 US 560 (1975).

Yet, Michigan's SBT is not aimed at wholesale transactions, traditionally viewed as locale-specific, which would justify such

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[9]It is a fair assumption that the gross proceeds from Trinova's automobile components, primarily window glass delivered to the automotive plants of GM (and other manufacturers) located outside of Michigan and the gross proceeds from Trinova's product delivered to the plants in Michigan contain a similar percentage of value added.

taxation. It is imposed on business activities "within this state, whether in intrastate, interstate or foreign commerce" SBTA §3(2), MCL 208.3(2).[10]

In recognition of the fact that the $58,853,446 of value added inherent in the products sold by Trinova in Michigan was generated not merely by the demand of the Michigan market, but also by productive capital and labor, Michigan employs a 3-factor formula to determine its share of

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[10]Moorman Manufacturing Co, supra, 437 US 267 (1978), might be read as validating a tax on values generated by multistate activities measured only by sales. However, such a reading would be inaccurate. Moorman, decided by its majority on due process grounds specifically held that a one-factor sales formula does not necessarily--and in the case of Moorman Manufacturing Company did not--violate due process by reaching values (income) out of all appropriate proportion to the intrastate activities of a multistate taxpayer.

this value added. The 3-factor formula assumes that capital, labor and market demand contribute equally to sales price or gross receipts.[11] Logically, therefore, these three factors may also be assumed to contribute equally to any derivative of gross receipts, whether it be net income or value added.

It follows that the $58,853,446 of value added reflected by the Michigan sales should be shared by the jurisdictions in which the contributing property and payroll expense is incurred. Michigan, the market state, laid claim only to slightly more than 1/3 of this value added of $58,853,446 by apportioning

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[11]Although the one-third-each weight given to the three factors is essentially arbitrary " ... the three-factor formula ... has gained wide approval precisely because payroll, property, and sales appear in combination to reflect a very large share of the activities by which value is generated." Container Corp, supra, 463 US at 183.

$19,838,700 of such value added (Petitioner's brief, p 15) or approximately 33.71% of the value added contained in the products sold in Michigan[12]. From this sum of $19,838,700 Trinova deducted $9,064 as net capital acquisition deduction and the remainder of $19,829,636 was reduced by 37%, the excess compensation reduction, to arrive at apportioned modified value added of $12,492,671. The rate of 2.35% applied to this base yielded a 1980 tax of $293,578.

B. VALUE ADDED IS GENERATED BY A SERIES OF TRANSACTIONS SPANNING THE UNITARY ENTERPRISE OF MANUFACTURE, DISTRIBUTION AND SALE OF PRODUCTS.

As noted above, this Court has never interpreted the Due Process and Commerce

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[12]$58,853,446 x 33.71% = $19,839,496. Application of the average apportionment factor of 8.9717% to Trinova's total value added of $221,125,319 resulted in an apportioned tax base of $19,838,700.

Clauses to require the use of any particular type of formulary apportionment. It has upheld the use of a one-factor property formula to apportion "net profits", Underwood Typewriter v Chamberlain, 254 US 113 (1920); a one-factor sales formula to apportion net income, Moorman Manufacturing Co, supra; and a single-factor gross receipts formula to attribute net worth (capital and surplus) Ford Motor Co v Beauchamp, 308 US 331 (1939). In Moorman, supra, the court refused to mandate a uniform apportionment formula noting that such mandate was within the power granted to Congress by the Commerce Clause, (437 US 277-280).

Trinova does not contest the fact that it is a unitary business, and it acknowledges (brief p 27) that income arising from multi-state activities of a unitary business is an

"appropriate subject for apportionment." It raises no objection to the use of a 3-factor formula to apportion net income (or loss), but it brands as unconstitutional the "inclusion of the sales factor" to apportion total value added.

Trinova argues that the Constitution requires that value-added taxes be fragmentized and that "tax base components" be separately allocated. If Trinova's erroneous arguments are accepted, the Single Business Tax would be converted to a series of separate taxes upon the elements which are transformed into value added. Alternatively, Trinova contends that this Court should interpret the Constitution to require 2-factor (property and payroll) apportionment of value added if, indeed, value added is an amalgam created by fusion of factors repre-

senting business activities which add cost to purchased material. On page 34 of its brief, Trinova presents an example of such two-factor apportionment and arrives at an apportioned tax base of $360,213. To complete the example, we may subtract the capital acquisition deduction of $9,064 and arrive at an adjusted apportioned tax base of $351,149 which is subject to further diminution by the excess compensation reduction (37% of $351,149) of $129,925. The final adjusted tax base of $221,224 multiplied by the tax rate of 2.35% would result in SBT of $5,199 for the privilege of doing business in Michigan which yielded $103,981,354 (Pet App 56a).

While the 3-factor apportionment formula is today accepted as a "benchmark" for attribution of multistate-generated income, the

inclusion of the sales factor in the income tax apportionment formulas was similarly criticized as late as 1960.[13] Some economic theorists insisted that income was the product of capital and labor and that the marketplace contributed nothing to the income production; it merely portrayed an "exchange of value."

Yet, this view was rejected by the drafters of the Uniform Division of Income for Tax Purposes Act (UDITPA), approved by the House of Delegates of the American Bar Association in 1957. This model act, designed for allocation and apportionment of income from multi-state business, adopted the

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[13]Harriss, Economic Aspects of Interstate Apportionment of Business Income, 37 Taxes, 327, 362-363 (1959); Studenski, The Need for Federal Curbs on State Taxes on Interstate Commerce: An Economist's Viewpoint, 46 Va Law Rev 1121, 1131-1132 (1960).

evenly weighted 3-factor formula of property, payroll and destination sales.

The rejected theory which equates the production of income exclusively with utilization of capital and labor and refuses to consider the participation and importance of market demand is resurrected in argument against 3-factor apportionment of value added (Pet brief p 34). It does not gain logical acceptability by redirecting its thrust. Apportionment of gross receipts and its

derivatives, net income or value added,[14] is best accomplished by giving weight to market demand (sales) as well as the productive factors of capital and labor, i.e., property and payroll.

Trinova repeatedly claims that value added can be measured solely by such internal costs as depreciation and compensation. This amounts to the assertion that economic events

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[14]The starting point in the computation of corporate taxable income are gross receipts which, by deduction of the cost of goods sold and/or operations, is transformed into gross profit. Thereafter, by addition of income items and deduction of expense items, it is converted to taxable income. Similarly, value added is derived by deducting material costs from gross receipts. In Mobil Oil Corp v Department of Treasury, supra, 422 Mich at 493, the Michigan Supreme Court noted that:

> "In the end, the income tax and the VAT tax the same things, but at different stages of the economic process, and thus generate the same amount of revenue and affect the economy identically."

that precede a sale, i.e., the incurring of internal costs, will predict the economic results of the sale that may subsequently occur. There is nothing in the record to support this proposition or the premise that the internal production costs incurred by an enterprise will increase, by a like amount, the prices and the value added that the goods and services of the enterprise will command in the market.

When an enterprise markets its products, consumer preferences, not production costs, determine the prices for which the products can be sold and the gross income the enterprise realizes. There is no assurance that the goods and services which a business sells will command prices that cover the cost of producing them.

Market prices show the value consumers place on the entire goods or services, not on

any of the individual elements that were combined in their production. Because of this indivisibility, precise information about an internal production cost cannot be translated into information about the value or gross income the enterprise may realize from sales. For example, labor costs can be precisely accounted for, but the influence of these costs on the market prices commanded by the goods produced by that labor, and thus the value added by that labor, cannot be ascertained. Value added, like net income, cannot be precisely divided between the factors that contributed to its generation.

The point is best illustrated by Trinova's own situation in 1980. For that year, its total preapportionment "value added" tax base (before special adjustments) was admittedly $221,125,319 as computed under

the Michigan statute. Yet its total compensation for the year was $226,356,271, and its combined total compensation and depreciation costs were $249,616,180, both well in excess of Trinova's admitted "value added" tax base of $221,125,319. Obviously, therefore, Trinova's 1980 costs that were added back under the "additive" method of computing value added did not by themselves establish the measure of Trinova's 1980 value added. Rather, the market presumably concluded that the value added by Trinova to its finished goods was less than the costs it incurred in the production process.

Just like income or gross receipts, value added is an amorphous concept and "arriving at precise territorial allocations of 'value' is often an elusive goal, both in theory and practice," Container Corp, supra, 463 US at 164.

Similarly in Butler Bros v McColgan, 315 US 501, 507 (1941), the Court said that separate accounting "does not prove appellant's assertion that extraterritorial values are being taxed," and in Amerada Hess, supra, 104 L Ed 2d at 67, the Court cited Container Corp and said, " ... the costs of a unitary business [what Trinova claims comprises the SBT tax base] cannot be deemed confined to the locality in which they are incurred."

C. THE SINGLE BUSINESS TAX REFLECTS A REASONABLE SENSE OF HOW INCOME IS GENERATED BY TRINOVA'S UNITARY ENTERPRISE AND PRODUCES A FAIR APPORTIONMENT OF VALUE ADDED.

In Complete Auto Transit, supra, 430 US 274, this Court sought to reconcile the demand that multistate business pay a fair share of state taxes with the need for a nationwide free trade area. It enunciated a

four-part test to judge the constitutional validity of state taxes imposed on multistate activities: Substantial nexus, fair apportionment, nondiscrimination against interstate commerce and a fair relationship of benefits provided by the state and the tax burden.

Trinova does not dispute that its Michigan activities supply the requisite nexus justifying exertion of the state's taxing power. Furthermore, it is uncontroverted that the "advantages provided by the state which aid appellants' business" Amerada Hess Corp, supra, 104 L Ed 2d 58, are fairly related to its tax burden. However, Trinova charges that the SBT does not fairly apportion value added by its unitary multistate business.

This charge of unfair apportionment is premised upon a misconception of the nature

of a value added tax as a series of taxes on separate elements of production costs plus profit. The SBT method[15] for determination of value added identifies cost elements and profit, but does not and clearly was not intended to assign a specific situs to the elements. Trinova's argument which ascribes such a function of geographic allocation to the addition method would render the entire concept of apportionment meaningless.

Trinova's claim of unfair apportionment is based upon a misconception of the nature

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[15]In A Proposal For A Michigan Value Added Tax, James Haughey, Department of Management and Budget, State of Michigan, December 27, 1974, notes that it would "be possible to calculate the tax by subtracting from sales the purchases made from other taxable firms. This was the approach of the Michigan BAT. However, several of the state's major taxpayers report that they used the addition method for the BAT tax anyway because it was easier and conformed more closely with the accounts and concepts required for federal income tax purposes." Appendix A6 of Amicus Curiae Caterpillar Inc.

of value added in the context of a unitary business. A unitary business of manufacture, distribution and sale adds value to its product by all of its operations, i.e., manufacturing, distributing, selling. Thus, neither its income nor the value added to its product is capable of geographic sourcing or attribution. These values are created by a series of integrated activities and realized only by sale of products, Bass, Ratcliff & Gretton, supra, 266 US 271, 282. They are properly divisible by the SBT's three-factor apportionment formula of property, payroll and sales among the jurisdictions wherein the value-adding or income-producing activities take place.

Trinova's characterization of the SBT as an "origin-principle" VAT is inaccurate. As explained by Trinova (brief p 6) the

"destination" label is applied to the national VATs of the European Economic Community. To encourage exports they rebate VAT on products which are exported, but impose their VAT rate against the total price of products sold. Consequently, value added at all stages in the production chain, whether in foreign countries or domestically, is subjected to tax in the consumer (destination) country. Obviously, if a State of the United States were to adopt such scheme of taxation, it would be challenged as an unapportioned tax on value added by multistate activities. It could only be defended as a state tax upon locale-specific sales transactions.

Constitutional problems would likewise arise if a state were to adopt a pure "origin-based" VAT and subject exports to tax

while exempting imports. Maryland v Louisiana, 451 US 725 (1981). Origin or destination principle VATs are premised upon allocation, not apportionment, of value added. Michigan's SBT, by contrast, is measured, in the case of multistate business, by apportioned (modified) value added. If there be need for such categorization, it might be labelled as a "neutrally based" VAT.

Regardless of labels, this Court has insisted that the formulary apportionment of multistate and multinational activities, privileges, and property should only be applied to "unitary" values. As stated in Mobil Oil Corp, supra, 445 US at 439, the unitary-business principle is "the linchpin of apportionability."

This Court has long and consistently recognized that if a business is unitary, it

is impossible as a practical and perhaps even theoretical matter, to determine the geographic or functional source of particular values. All activities of an integrated business make some contribution to the production of income, to the net worth of the business and, we submit, to value added. Container Corp, 463 US at 164, 165; Butler Bros, supra, 315 US at 506, 507; Bass, Ratcliff & Gretton, supra, 266 US at 282.

This Court has traditionally focused upon the Due Process Clause in determining the validity of formulary apportionment. To sustain a claim of unconstitutional apportionment a taxpayer must produce "clear and cogent" evidence that the multistate value attributed by the state apportionment formula was "out of all appropriate proportion to the actual business transacted" in the state.

Butler Bros, supra, 315 US at 507; Hans Rees' Sons v North Carolina, 283 US 123, 135 (1930); Moorman Manufacturing Co, supra, 437 US at 274; Exxon Corp, supra, 447 US at 220.

Trinova apparently believes that the Michigan tax on value added is so different from a tax on net income that the justification set forth in cases like Mobil for rejecting a requirement of separate geographical accounting is simply inapposite here. But the basis for this Court's position in Mobil is not that separate accounting is inappropriate for an income tax, but that it is inappropriate for a unitary business. Michigan submits that for purposes of determining whether separate geographical accounting must be utilized by a state seeking to tax a unitary enterprise engaged in business activity within its borders there

is no constitutional difference between an income tax and a value added tax.

In Mobil, supra, 445 US at 438, the Court noted:

> "--separate accounting, while it purports to isolate portions of income received in various states, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale."

The Court then concluded that since:

> "...such factors arise from the operation of the business as a whole, it becomes misleading to characterize the income of the business as having a single identifiable 'source.'"

In Exxon Corp, supra, 447 US at 229-230, the Court concluded:

> "In short, the Commerce Clause does not require that any income which a taxpayer is able to separate through accounting methods and attribute to exploration and production of crude oil and gas be allocated to the states in which those production centers are located. The geographic location of such raw materials

> does not alter the fact that such income is part of the unitary business of the interstate enterprise and is subject to fair apportionment among all states to which there is a sufficient nexus with the interstate activities of the business."

Here, that portion of value added which Trinova by separate accounting seeks to exclude from its products sold in Michigan is produced by unitary multistate activities and is subject to fair apportionment which reflects a reasonable sense of how its income is generated. The rule set forth by this Court in Container Corp and Mobil is directly relevant and controlling here--separate geographical accounting is not constitutionally required for state taxation of a unitary business.

On three occasions this Court struck down state tax apportionment methods as applied to unique individual circumstances. In Union

Tankline Co v Wright, 249 US 275 (1919), the Court held that a mileage apportionment formula which attributed to Georgia's taxing jurisdiction approximately six times the value of mobile property actually located in the state was:

> " ... an arbitrary method which produced results wholly unreasonable, and that to permit enforcement of the proposed tax would deprive it of property without due process of law and also unduly burden interstate commerce." 249 US 283.

In Hans Rees' Sons, Inc, supra, 283 US 123, the Court invalidated a four-fold attribution of income to North Carolina which resulted from a one-factor apportionment formula consisting of property. In Norfolk and Western Railway Co, supra, 390 US 317, the court invalidated the apportionment of systemwide property value by a one-factor mileage formula which resulted in attribution

of value 2 and 1/2 times of actual undisputed inventory.

Similarly, in Mobil, Exxon, Amerada Hess, and Shell Oil Co, supra, 102 L Ed 2d 186, the taxpayers pressed their own individual case insisting that the apportionment formula as applied to their circumstances reached a constitutionally impermissible result. The main thrust of argument in these cases was aimed at the due process restrictions upon state taxing authority, the limitation of taxing jurisdiction and the prohibition to project it beyond the state's borders.

In Moorman, supra, equal emphasis was shifted to a Commerce Clause analysis. The single factor sales formula was assailed as economic protectionism, a tariff on goods manufactured in other states and a subsidy to Iowa manufacturers. The Court was asked to

decree that the formula was invalid as an impediment of or discrimination against non-domiciliary business in violation of the Commerce Clause. Further or alternatively, the Court was requested to find that Iowa's apportionment formula projected its taxing power upon extra-territorial values in violation of the due process rights of Moorman Manufacturing Company.

A majority of the Court decided the case on due process grounds and ultimately found no convincing evidence of extraterritorial taxation by Iowa of Moorman's multistate income. A minority of the Court employing a Commerce Clause analysis proposed to condemn the Iowa single-factor formula, although Mr. Justice Blackmun's dissent agrees "that application of Iowa's formula does not violate the Due Process Clause." 437 US 286.

Trinova and a host of litigants in the Michigan courts[16] argue that the Constitution requires that multistate value added be attributed by separate accounting of its site-specific components, i.e., compensation, depreciation, royalties paid, etc. They present no evidence of extraterritorial taxation; they simply assert that value added must be split into its basic elements and that these elements be separately exposed to taxation.

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[16]At the present time there are pending 471 cases with an amount of tax in controversy in excess of $145,000,000 plus an indeterminate amount of interest.

II.

THE APPORTIONMENT OF VALUE ADDED BY A THREE-FACTOR FORMULA OF PROPERTY, PAYROLL AND SALES DOES NOT DISCRIMINATE AGAINST OUT-OF-STATE BUSINESSES AND THE COMMERCE CLAUSE DOES NOT MANDATE FISSION OF VALUE ADDED AND SEPARATE TAXATION OF ITS FRAGMENTS.

Trinova invokes the Commerce Clause to escape from the yoke of taxation upon its modified value added. It charges that the SBT apportionment formula imposes a heavier burden on out-of-state businesses that compete in an interstate market than it imposes on Michigan-domiciled business which also engages in interstate commerce.

Trinova has offered no credible evidence to sustain its charge. Trinova's discrimination argument is premised upon its misconstruction of the SBT as a tax upon compensation and depreciation. Amici Alcan Aluminum Corporation, et al, and Caterpillar

characterize the SBT as "a tax on compensation and depreciation" (Alcan brief p 13) and "a tax on labor" (Caterpillar brief p 16). These characterizations are at odds with the professed legislative objective of stimulating the development and investment of business within Michigan (Pet App 73a). A tax on payrolls would penalize job creation in Michigan.

On page 39 et seq of its brief, Trinova purports to compare the SBT liability of a Michigan business and an Ohio business. However, that comparison is not of SBT burden; it compares a hypothetical tax on compensation, not a tax on value added. The Michigan business with an average apportionment factor of 85 1/3%

$$\frac{\text{property} + \text{payroll} + \text{sales}}{3} = \frac{98\% + 98\% + 60\%}{3}$$

will apportion to Michigan $1,280,000 of its

$1,500,000 total value added.[17] The Ohio business with an average apportionment factor of 14 2/3% ($\frac{2\% + 2\% + 40\%}{3}$) will apportion $220,000. If there are no additional modifications (such as capital acquisition deduction and recapture, excess compensation reduction) the apportioned value added of the Michigan business, at a tax rate of 2.35% will result in an SBT liability of $30,080 whereas the Ohio business will have an SBT liability of $5,170.

While the validity of a state tax on multistate business does not depend upon the operative effect of taxes levied by other jurisdictions in which the business operates, Moorman Manufacturing Co, supra; New Energy

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[17] $1,500,000 = total (pre-apportioned) tax base = total (pre-apportioned) value added.

Co v Limbach, 486 US ____, 100 L Ed 2d 302 (1988), it should not escape attention that the hypothetical Michigan business is also subject to an Ohio tax upon 21% of its total income, whereas the Ohio business apportions 79% of its income to Ohio. This results from Ohio's use of a four-factor income tax apportionment formula [Ohio Rev. Code, sect. 5733.05(B)(2)] consisting of one factor for property, one factor for payroll and two factors for sales.[18]

Thus, the Michigan business is subjected to taxation of 85 1/3% of its value added and 21% of its income; the Ohio business to taxa-

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[18]The Michigan business is subject to apportionment of $\frac{2\% + 2\% + 40\% + 40\%}{4} = \frac{84\%}{4} = 21\%$

The Ohio business is subject to apportionment of $\frac{98\% + 98\% + 60\% + 60\%}{4} = \frac{316\%}{4} = 79\%$

tion of 14 2/3% of its value added and 79% of its income.

The Michigan tax is imposed "upon the privilege of doing business" [SBTA sec 31(4); MCL 208.31(4)]; the Ohio tax "for the privilege of doing business in this state" [Ohio Rev. Code 5733.01(A)]. The allocation and apportionment provisions of both taxes are designed to fairly "represent the extent of the taxpayer's business activity in this state" [Ohic Rev. Code 5733.05(B)(2)(d) and SBTA sec. 69; MCL 208.69]. Since both value added and income are employed to reflect proportional activity, it can be argued that the hypothetical Michigan business must pay tax on 106 1/3% of its activities and the Ohio business only on 93 2/3% of its activities.

In General Motors Corp v District of Columbia, 380 US 553 (1965), the Court

invalidated a regulation promulgated by the District tax commissioners which provided that the District's franchise tax measured by net income should be apportioned by a single factor sales formula. While the case involved the validity of an administrative regulation, and does not turn on the due process analysis employed in decision of state tax apportionment cases, its rationale is compelling. The Court stated, 380 US at 559:

> "The great majority of states imposing corporate income taxes apportion the total income of a corporation by application of a 3-factor formula which gives equal weight to the geographical distribution of plant, payroll, and sales."

At 380 US 561, 14 L Ed 2d 73, 74, the Court explains further:

> "The standard 3-factor formula can be justified as a rough, practical approximation of the distribution of either a corporation's sources of income or the source of costs which it generates. By

> contrast, the geographic distribution of a corporation's sales is, by itself, of dubious significance in indicating the locus of either factor."

The apportionment formula of the SBT does not favor Michigan-domiciled industry. Favorable accommodation of domestic business as accomplished by apportionment methods, such as the employment of four-factor formulas[19] or a single-factor sales formula (as employed by Iowa) is foreign to Michigan tax law which has always sought neutrality of tax burden for multistate firms regardless of

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[19]Nine states use a 4-factor or "double-weighted sales factor" formula: Florida, Illinois, Kentucky, Massachusetts, New York, North Carolina, Ohio, West Virginia, and Wisconsin. CCH Multistate Corporate Income Tax Guide, ¶146. Such formulas may reflect the economic theory which gives equal weight to supply and demand in achieving price levels. It can be argued that the magnitude of gross receipts, income or value added is dependent, to an equal degree, upon supply (property and payroll) and demand (sales).

their business domicile. Such neutrality is best achieved "in the context of general use of the three-factor approach," General Motors Corp, supra, 380 US at 559, by the standard 3-factor apportionment formula employed by the SBT to apportion value added.

Respondent also notes that statistical data does not support Trinova's charge of discrimination. Analysis Of The Michigan Single Business Tax, supra, at p 7 concludes: "For all businesses together, single business taxes average about 0.4 percent of sales... . In other words, the SBT takes, on average, less than one-half of 1-cent per dollar of sales..."

Trinova had Michigan sales of $103,981,354 (Pet App 56a) and an SBT liability of $293,578 (Petitioner's brief, p 15). Consequently, Trinova's SBT liability amounts

to 0.285 percent of its Michigan sales which is but two-thirds of the average tax burden for all single business taxpayers.

The three-factor apportionment formula of the single business tax does not discriminate against out-of-state businesses. It treats both local and foreign concerns with an even hand., Trinova's "discrimination" claim vanishes with its underlying premise that the Constitution requires the "sourcing" of elements which, by unitary multistate activities, are fused into value added.

The SBT is a tax upon business activities measured by modified value added. It assumes that value is added to a product by three major factors; capital, labor, market demand, i.e., property, payroll and sales. Consequently, value added to a product which is produced and sold in different taxing

jurisdictions is subjected to apportionment by these factors.

Trinova argues that apportionment of value added is neither necessary nor constitutionally acceptable. Its separate accounting theories, it is argued, can identify the "sources" of value added and can precisely allocate portions or elements of value added to specific jurisdictions.[20]

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[20]Trinova's citation of authority (Pet brief p 26) is wrong as to form, authoriship, premise and substantive conclusion. The quote is from Michigan's Fiscal and Economic Structure; Chapter 22, the Single Business Tax; pp 673-719, 704, authored by Robin Barlow, a professor of economics and Jack S. Connell, Jr., an undergraduate student in economics at the University of Michigan. It is premised on the mistaken notion that the SBT taxes economic "inputs", i.e., imposes distinct levies upon costs which in conjunction with profits equate value added. It professes a preference for separate accounting over essentially arbitrary and inexact apportionment and concludes that formulary apportionment should not include a sales factor because sales "are not a component of value added."

Similar argument was rejected by this court in Mobil Oil, supra, Exxon, supra, Shell Oil, supra, Amerada Hess, supra and Butler Bros, supra.

In Shell Oil Co, supra, 102 L Ed 2d 186, the Court upheld the inclusion of income derived from outer continental shelf activities within the unitary (pre-apportioned) tax base of Iowa's income tax. It rejected Shell's argument that revenues derived from oil and gas production on the outer continental shelf, far distant from Iowa, should be attributed to their source. The Court stated, 102 L Ed 2d at 199:

> "Shell's argument hinges on the mistaken premise that including OCS-derived income in the pre-apportionment tax base is tantamount to the direct taxation of OCS production. But income that is included in the pre-apportionment tax base is not, by virtue of that inclusion taxed by the State. Only the fraction of total income that the apportionment formula determines (by multiplying the income tax base by the apportionment fraction) to be attri-

butable to Iowa's taxing jurisdiction is taxed by Iowa. As our commerce clause analysis of apportionment formulas has made clear, the inclusion of income in the pre-apportioned tax base of a state apportionment formula does not amount to extraterritorial taxation. This Court has repeatedly emphasized that the function of an apportionment formula is to determine the portion of a unitary business' income that can be fairly attributed to instate activities. Exxon Corp v Wisconsin Department of Revenue, 447 US 207, 219 (1980); Mobil Oil Corp v Commissioner of Taxes, on remand, 445 US 425, 440 (1980)."

The opinion in Amerada Hess, supra, commences with the following recital of fact:

"Appellants in this litigation are 13 major oil companies that do business in the state of New Jersey. They are subject to New Jersey's corporation business tax. They also are subject to the federal windfall profit tax imposed on producers of crude oil. None of appellant's oil production takes place in New Jersey.

Each appellant has sought to deduct its federal windfall profits tax in calculating 'entire net income' for purposes of the New Jersey corporation business tax." 104 L Ed 2d 64.

The taxpayers argued that the federal windfall profit tax was a cost so closely

associated with oil production at the wellhead that it could not be associated with their "unitary business" or "unitary income." In other words, the taxpayers argued that the windfall profits tax was site-specific and isolated to the oil-producing states; that it could not be considered by New Jersey in determining what proportion of their unitary activities and income was subject to taxation by the state.

The Court analyzed these constitutional objections, testing them against the "four prongs of the Complete Auto test." 104 L Ed 67. It first found that New Jersey had a substantial nexus with the activities that generated appellant's entire net income, including all production occurring entirely outside the state. Secondly, it found that New Jersey imposed upon the oil companies a properly apportioned tax and employed

> " ... an apportionment formula that averages the percentages of instate property, receipts and payroll ... we have expressly approved this apportionment formula in the past. See, e.g., Container Corp of America v Franchise Tax Board, 463 US 159, 170 (1983). Indeed this 3-factor formula 'has become ... something of a benchmark against which other apportionment formulas are judged.'" 104 L Ed 2d 67.

Next, the Court found that the tax (its jurisdiction validated by substantial nexus and being fairly apportioned) did not discriminate against interstate commerce. It was neither facially nor impliedly discriminatory against out-of-state industry. Finally, the Court found that police and fire protection, the benefit of a trained work force and the advantages of a civilized society were guaranteed by the laws of New Jersey and were benefits fairly related to the burden of taxation, and the tax paid by the oil companies was "related to the advantages provided by the state which aid (each) appellant's business". 104 L Ed 2d 67.

The principles of Shell Oil and Amerada Hess should be applied with equal force to Michigan's SBT and the facts of this case.

The cases cited by Trinova in support of its discrimination argument deal, as acknowledged on page 42 of its brief, with "tax credits and tax exemptions which favored local business." In these cases the court invoked the Commerce Clause to prohibit designed geographical bias favoring domestic business to the detriment of out-of-state business. By contrast, in its decisions dealing with apportionment of multistate values, the court has traditionally employed a due process analysis.

Westinghouse Electric Corp, supra, 466 US 388, involved a credit for exports shipped

from the state; Tyler Pipe Industries, Inc, supra, 483 US 232, involved a tax credit for local manufacturers; Boston Stock Exchange, supra, 429 US 318, dealt with a 50% tax reduction for sale and transfer of stock within the state; Maryland v Louisiana, supra, 451 US 725, invalidated a natural gas tax from which instate users were partially exempt; and in American Trucking Associations, Inc, supra, 483 US 266, a commercial advantage was given to local truckers by imposition of a flat rate unapportioned axle tax. In New Energy Co, supra, 100 L Ed 2d at 308, the Court held that "the Commerce Clause prohibits economic protectionism--that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors." The case dealt with a sales tax credit available only for ethanol produced in Ohio or a state with a similar reciprocal credit.

The SBT apportionment provisions, unlike the tax credits and exemptions involved in the foregoing cases (or unlike an unapportioned tax), do not reflect geographical bias. To the contrary, the activities of multistate business reflected by value added are attributed to Michigan by geographically neutral comparisons of property, payroll and sales. It is Trinova and its Amici which insist on geographically biased accounting for value added by seeking to allocate compensation and depreciation.

Trinova mentions the capital acquisition deduction of the SBT and litigation concerning its constitutionality in footnote 14 and on page 44 of its brief. It states that the "discriminatory effect" of the capital acquisition deduction (which is not at issue in this case) evidences a legislative

"attempt to favor instate businesses at the expense of out-of-state businesses." Trinova's effort to expand this case beyond its record is unworthy of extended comment.[21]

Similarly, Trinova's implication that the SBT was intended and designed to systematically reduce the tax burden of local business at the expense of out-of-state businesses (Petitioner's brief pp 38, 39) and the implied suggestion that the SBT is being "exported" i.e., its burden shifted to taxpayers outside the state (Petitioner's brief p 43) deserve only summary response.

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[21]The state's brief in Caterpillar, Inc v Michigan, Michigan Court of Appeals No. 119548 focuses upon New Energy Co, supra, Scheiner, supra, Tyler Pipe Industries, Inc v Washington State Department of Revenue, supra, Westinghouse v Tulley, supra, Maryland v Louisiana, supra, Boston Stock Exchange, supra.

There exists no proof that the SBT favors local business aside from the imaginative but falsely-premised separate accounting theories of Trinova. Its SBT burden places a charge against Trinova's Michigan gross receipts which is only two-thirds of the average charge against gross receipts of single business taxpayers as a whole.

There exists an identical lack of proof that the SBT is being "exported" and the implied claim of exportation is similarly premised upon Trinova's separate geographic accounting theories. It is untenable since "the borders between the States are essentially irrelevant" to the SBT burden, Commonwealth Edison Co v Montana, 453 US 609, 619 (1981); and the SBT respects the area of free trade among the several States which is secured by the Commerce Clause. McLeod v J.

E. Dilworth Co, 322 US 327, 330 (1944); Commonwealth Edison Co v Montana, supra.

CONCLUSION

Mr. Justice Frankfurter, recognizing the limited function of the courts, wrote in Wisconsin v J C Penney Co, 311 US 435, 445 (1940):

> " ... At best, the responsibility for devising just and productive sources of revenue challenges the wit of legislators. Nothing can be less helpful than for courts to go beyond the extremely limited restrictions that the Constitution places upon the states and to inject themselves in a merely negative way into the delicate processes of fiscal policy making. We must be on guard against imprisoning the taxing power of the states within formulas that are not compelled by the Constitution but merely represent judicial generalizations exceeding the concrete circumstances which they profess to summarize."

Prior to 1976, the State of Michigan imposed a variety of business taxes. The

most important of these, the corporate income tax was unpredictably cyclical; the personal property tax on inventories was an anachronism; and a variety of privilege taxes including the corporate franchise tax were administratively burdensome to both taxpayer and taxing authority. Thus, the Michigan Legislature replaced these taxes in 1976 by the Michigan Single Business Tax. This tax reform and simplification merged several subjects of taxation into a single tax on the privilege of doing business.

The Michigan SBT is a modified value added tax. It is designed to capture for taxation the value or cost added to a product or service by a taxpayer's business activities. Because of the business community's familiarity with federal income tax law, it was decided to provide for an addition rather

than subtraction method of determining value added. Thus, a taxpayer's tax base is computed by starting with its net income from all operations and then adding total compensation, depreciation, royalties paid, interest paid, all of which reflect value added to a product or service. The tax base of a multistate taxpayer is apportioned to Michigan by application to the total tax base of the standard three-factor apportionment formula.

Trinova's challenge is based on the quicksand of rejected theories which equate financial gain or loss from multistate activities with capital and labor and which deny that market demand contributes to the creation of value added.

Trinova's SBT burden amounts to less than 29 cents for each $100 of its Michigan sales,

considerably less than the burden of the average single business taxpayer. Yet, its separate accounting argument concludes that it should pay zero tax for its privilege of doing business in Michigan.

Mr. Justice Frankfurter's remarks in Wisconsin v J C Penney Co, supra, are instructive:

> "For constitutional purposes the decisive issue turns on the operating incidence of a challenged tax. A state is free to pursue its own fiscal policies, unembarrassed by the Constitution, if by the practical operation of a tax the state has exerted its power in relation to opportunities which it has given, to protection which it has afforded, to benefits which it has conferred by the fact of being an orderly, civilized society." 311 US 444.

RELIEF SOUGHT

The judgment of the Supreme Court of Michigan should be affirmed.

Respectfully submitted,

FRANK J. KELLEY
Attorney General

Gay Secor Hardy
Solicitor General

Thomas L. Casey
Assistant Solicitor General
Counsel of Record
P. O. Box 30212
Lansing, MI 48909
(517) 373-1124

Richard R. Roesch
Assistant Attorney General
Attorneys for Respondent